

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS NUMBER: 05-0493**  
**Income Tax**  
**For Tax Years 2001-2002**

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUE**

**I. Gross Income Tax—Imposition**

**Authority:** *1 Stop Auto Sales, Inc.*, 810 N.E.2d 686, 690 (Ind. 2004); IC § 6-8.1-5-1; 45 IAC 1.1-2-4; 45 IAC 1.1-3-3; 45 IAC 1.1-4-2; 45 IAC 1.1-4-5

Taxpayer protests the assessment of gross income tax.

**STATEMENT OF FACTS**

Taxpayer is an Indiana business with operations in Indiana and other states. As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments for gross income tax. Taxpayer protests a portion of these assessments. Further facts will be supplied as required.

**I. Gross Income Tax—Imposition**

**DISCUSSION**

Taxpayer protests a portion of gross income tax for the tax years 2001 and 2002. The gross income tax was repealed in 2003. Taxpayer believes that the preliminary report provided by the field auditor prior to the final audit report is correct. That preliminary report results in some gross income tax due for 2001 and a refund for 2002, resulting in a small refund for the two years combined. The Department notes that IC § 6-8.1-5-1(c) [previously IC § 6-8.1-5-1(b)] places the burden of proving a proposed assessment wrong on the Taxpayer.

In the audit report, the Department stated that Taxpayer underreported income subject to the high rate of gross income tax for both years at issue. The Department referred to 45 IAC 1.1-2-4. As in effect during the audit period, 45 IAC 1.1-2-4 stated:

- (a) Taxable gross income from the following business transactions is subject to a tax rate of one and two-tenths percent (1.2%):
- (1) Producing, transmitting, furnishing, wholesaling, or retailing:
    - (A) electrical energy; or
    - (B) artificial gas, natural gas, or a mixture of the two (2) gases.
  - (2) Operating:
    - (A) a steam or electric railway, street car line, motor vehicle, steam or motorboat, or any other vehicle for the transportation of freight or passengers;
    - (B) a pipeline for the transportation of any commodity;
    - (C) a telephone or telegraph line;
    - (D) a water or sewerage system; or
    - (E) any other utility not specifically described in this subdivision.
  - (3) Activities described in IC 6-2.1-1-3 through IC 6-2.1-1-9.
  - (4) Any activity not specifically described in section 2 of this rule, including the following:
    - (A) The provision of services of any character.
    - (B) The sale of real estate.
    - (C) Rentals.
    - (D) The performance of contracts.
    - (E) The investment of capital.
    - (F) The sale of a capital asset.
    - (G) The provision of cable television.
    - (H) The extension of credit.
- (b) If a taxpayer fails to separate, in its records and on its tax return, the gross income subject to the high rate from the gross income subject to the low rate, the taxpayer's entire gross income is subject to the rate imposed by subsection (a).

This is the only explanation given in the final audit report. Taxpayer states that the Department's final audit report failed to take into account the fact that Taxpayer filed combined returns including Taxpayer and two other related companies for Indiana purposes and individual returns for each company for federal purposes.

Taxpayer claims several audit report errors. Taxpayer claims that the Department did not give proper credit for interstate sales, bad debt deductions, expense reimbursements and other inter-company expenses. Indiana's gross income tax regulations did provide deductions for these items. 45 IAC 1.1-3-3 provided a deduction for gross income derived from interstate commerce. 45 IAC 1.1-4-2 provided a deduction for bad debts. The bad debt deduction is limited to the amount a taxpayer writes off for federal income tax purposes, as explained in *1 Stop Auto Sales, Inc.*, 810 N.E.2d 686, 690 (Ind. 2004). 45 IAC 1.1-4-5 provided a deduction for intercompany transactions.

Taxpayer is correct that these deductions existed in the gross income tax regulations. However, while Taxpayer's argument is understandable, additional documentation is required to verify the validity and amounts of the deductions. These are not issues of law, but rather are issues of documentation. The most efficient method for clarifying and resolving these differing positions

is to conduct a supplemental audit. A supplemental audit will provide Taxpayer with the opportunity to provide documentation directly to an auditor. For instance, the amount claimed for interstate sales will require documentation establishing that the sales did indeed occur in interstate transactions.

Similarly, documentation establishing that Taxpayer's customer went bankrupt and did not pay resulting in bad debt to write off will be required. Also, documentation establishing that intercompany transfers were actually transferred between companies included on the combined return will be required. All of the deductions Taxpayer claims will require documentation at this level. If the documentation provided supports Taxpayer's claim for the deductions at issue, the supplemental audit will apply the deductions in the amounts verified by the documentation.

The final issue to address is found at the end of Taxpayer's supplemental protest, which was received May 3, 2007. Taxpayer states that, if the Department should have any opposing positions on the details, Taxpayer respectfully asks for an explanation and cited proof for the Department's position. As previously explained, IC § 6-8.1-5-1(c) places the burden of proving a proposed assessment wrong on the person against whom the proposed assessment is made. The Department takes this opportunity to remind Taxpayer that the burden of providing satisfactory documentation during the supplemental audit rests with Taxpayer. If satisfactory documentation is not provided, the supplemental audit will be unable to verify the claims and will not make any changes to the proposed assessments.

### **FINDING**

Taxpayer's protest is sustained, subject to audit review.

WL/BK/DK July 20, 2007